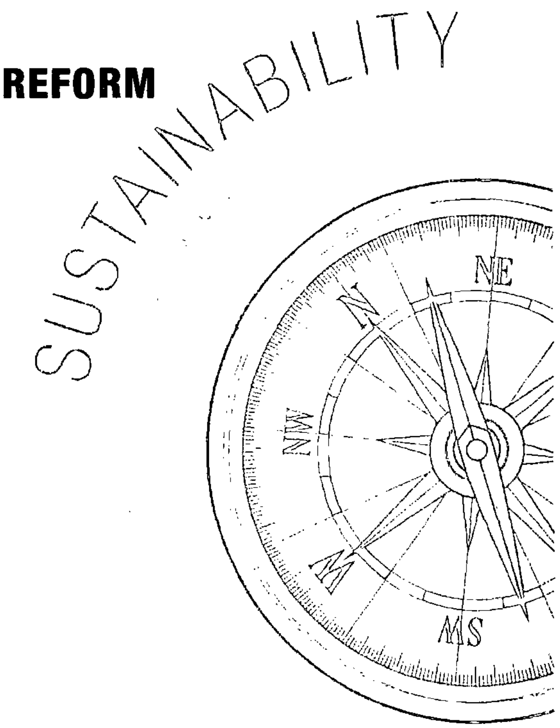
CHARTING a New Course
A VISION FOR PUBLIC SECTOR PENSION REFORM



ATB

Alberta Government

CHARTING a New Course
A VISION FOR PUBLIC SECTOR PENSION REFORM

A Message from the Honourable Doug Horner,
President of Treasury Board and Minister of Finance

Alberta's public sector pension plans are facing unprecedented challenges. Lower investment returns, early retirements and increased life expectancies have made it difficult for the plans' funds to catch up to their commitments. This has resulted in a multi-billion dollar unfunded liability that taxpayers and plan members are responsible for.

Unfortunately, the problem cannot be solved through raising contributions and waiting for higher investment returns. The sustainability of the plans is a complex issue, one our government will address now before the problem grows bigger.

The changes I am putting forward will result in a pension system that is more adaptable and responsive to changing conditions. It is my hope that the changes laid out in this document will put our pension plans on a sustainable course with good governance, and keep us living within our means.

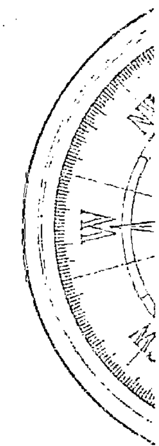
More than 200,000 active plan members and more than 120,000 retirees and deferred retirees are counting on us to get these changes right. So too, are Alberta taxpayers. This is why I will be working closely with the pension plan boards and stakeholders to ensure the proposed changes are fair to all stakeholders and that all plan members have a clear picture of the changes to come.

From now to the end of December 2013, I would like to hear from the employee and employer stakeholders of each plan about these proposals. I will take your responses into account as we prepare legislation for the Spring of 2014.

I look forward to hearing from you as we work together to build a system that will serve everyone's needs for generations to come.

Doug Horner

September, 2013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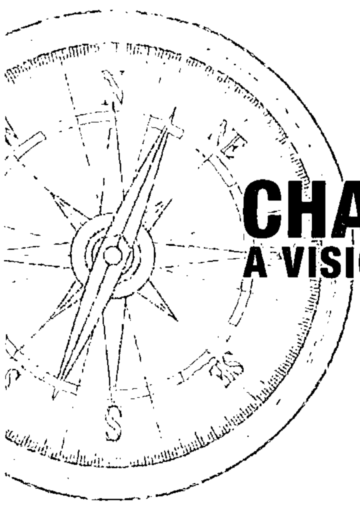


CHARTING a New Course
A VISION FOR PUBLIC SECTOR PENSION REFORM

Introduction

The Government of Alberta wants to make public sector pension plans more secure, adaptable and affordable.

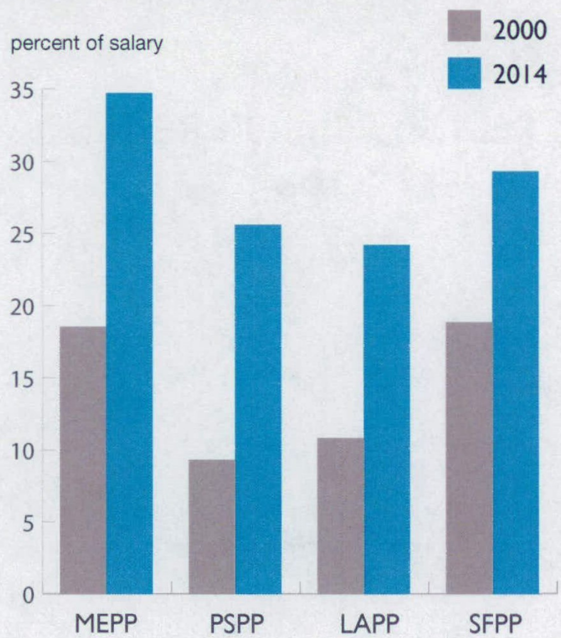
Many defined benefit pension plans are facing significant funding deficits due to lower returns on investment, early retirements, the increasing ratio of pensioners to contributing members, and increased life expectancies. Many plans will not be sustainable in the long term if changes are not made to address these challenges.

Alberta is not immune. Alberta public sector pension plans face the same challenges. This vision focuses on the Local Authorities Pension Plan (LAPP), the Public Service Pension Plan (PSPP), the Management Employees Pension Plan (MEPP) and the Special Forces Pension Plan (SFPP). Together these plans cover public sector employees across the province and have roughly 200,000 active members and over 120,000 retirees and deferred retirees.

The current pension plans were designed decades ago, and much has changed. On average, today's workers will retire three years earlier and live four years longer than those who retired a generation ago. Many will spend more years in retirement than they spent working. Returns on investments have been volatile for more than a decade.

The combination of these factors has resulted in the plans being underfunded. Total contribution rates for employees and employers are 25 per cent of salaries or higher – among the highest in Canada. Employees typically pay about half the cost through their own contributions.

TOTAL CONTRIBUTION RATES



Despite high contribution rates, assets of $35 billion, and investment returns on par with other large pension plans, these four plans have unfunded liabilities totaling over $7.4 billion.

ASSETS, LIABILITIES, UNFUNDED LIABILITIES

As at December 31, 2012

Sources: pension plan annual reports; consolidated financial statements of the Province

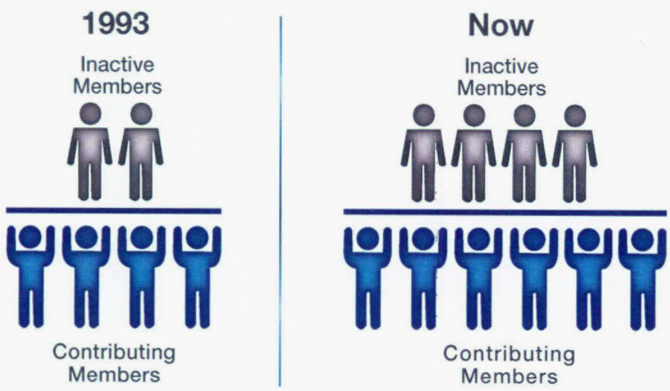
	MEPP	PSPP	LAPP	SFPP	Total
			$ millions		
Assets	$ 2,986	$ 7,300	$ 22,862	$ 1,749	$ 34,897
Liability	3,289	8,945	27,839	2,248	42,321
Unfunded Liability (UFL)	303	1,645	4,977	499	7,424
Province's Share of UFL	185	728	1,705	123	2,741

Public sector employers – the Government, and employers in the education, health and municipal sectors – need the right benefits at the right price to attract and retain a quality public sector workforce. It no longer makes sense, with an aging population and predicted skills shortages, to encourage people to retire early by subsidizing their pensions. Many of today's more mobile workers will not work in one place for 30 years and retire early, and it is not fair to expect them to pay higher contributions for those who do.

Even if interest rates rise and returns on investments continue to improve, Alberta's public sector pension plans will continue to face significant risk because of the maturity of the plans and improved longevity. Mature plans rely heavily on investment earnings to pay for pensions, but if investment returns fail to keep pace with the rising cost of benefits, a mature plan can quickly see a large shortfall develop.

Higher interest rates and strong investment returns in the future would help, but the opposite may happen. In any case, the risks facing mature plans will not go away.

THESE PENSION PLANS ARE MATURING



This is what has happened in the last decade, resulting in an increasing cost burden on current members, who must cover their share of shortfalls as well as contributing toward their own future benefits. Current taxpayers are in the same situation – paying for their share of ongoing costs as well as for the shortfalls for benefits already earned.

It is not a crisis, but it could become one unless action is taken to set our pension plans on the right course.

Higher interest rates and strong investment returns in the future would help, but the opposite may happen. In any case, the risks facing mature plans will not go away.

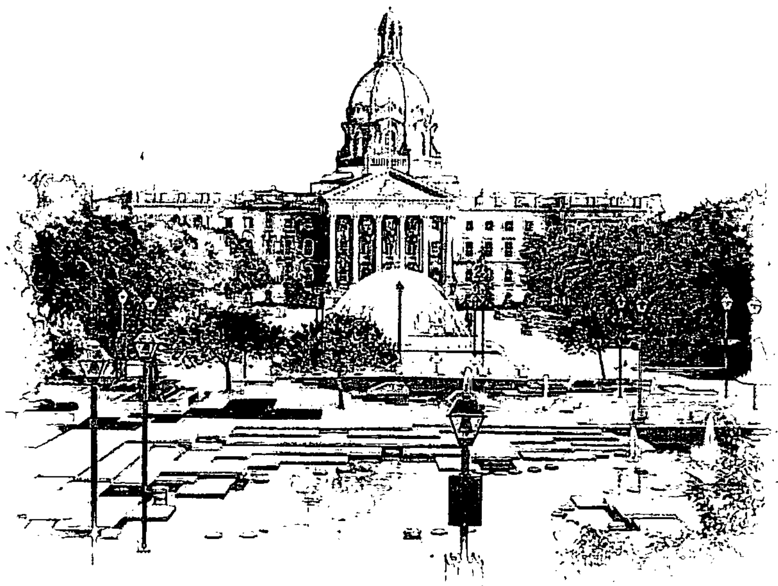
It is a measured approach, a change of course leading to a sustainable system in the long-term.

It is not a crisis, but it could become one unless action is taken to set our pension plans on the right course. The Government intends to make changes to address both cost and risk, and then put a new governance system in place that will be able to respond to changing conditions in the future. It is a measured approach, a change of course leading to a sustainable system in the long-term, but not putting undue financial stress on today's employees, taxpayers or pensioners.

Benefits earned up to the end of 2015 will be unaffected.

Benefits earned up to the end of 2015 will be unaffected. For service after 2016, benefits will be more modest but the plans will still be excellent retirement savings vehicles – providing reasonable, cost-effective and highly secure pensions.

Changes in design and governance will result in a public sector pension system that is more flexible and responsive to changing conditions, whether the future holds good times or bad. Employees and public employers, who share the cost and risk of these plans, will have the flexibility to manage their costs and risks. They will operate within reasonable constraints that protect contributing members and taxpayers from excessive costs, while providing highly secure and predictable pensions.



Government's Principles for Reforms

Contributions are affordable and sustainable for employers and employees with minimal additional legacy costs or future increases borne by taxpayers.

Benefits already earned are preserved.

A high degree of benefit security is provided.

Pensions provide reasonable income replacement.

Benefits are competitive and enable recruitment and retention of high-quality staff at all levels of the public sector.

The system is robust and adaptable to changing circumstances.

There is intergenerational fairness for members and taxpayers.

Those who bear the costs and risks can manage them through the governance system.

The governors of the system are accountable to taxpayers and beneficiaries.

Adequate notice is given to plan members and employers.

Proposals: Key Features

This is intended as a high-level proposal for reforms to the public sector pension system. Reforms will take place over the next few years, beginning with some benefit changes and legislation that will enable a new governance system to be created by public sector employers and unions.

After the reforms are fully implemented, the plans will be jointly sponsored, managed defined benefit pension plans. "Managed defined benefit" means that the plans provide pensions that offer a high degree of security and predictability, managed within a framework that recognizes costs and risks, and ensures that those directly affected make the decisions to address costs and risks, and keep the plans sustainable.

The plans will be jointly sponsored, managed defined benefit pension plans.

The main features of the reforms, to take effect on or after January 1, 2016, are:

- The Management Employees Pension Plan (MEPP) will be closed to new members at the end of 2015 with new managers (newly hired, or promoted into management) participating in the Public Service Pension Plan.
- Any time from January 1, 2016, PSPP, LAPP, and SFPP can become jointly sponsored by the major employee and employer stakeholders of each plan if sponsors reach agreement. They will continue to be jointly funded by employees and employers, who will continue to pay for the cost of new benefits earned as well as paying off any shortfalls over a maximum of 15 years.
- The sponsors will set benefits and funding policies within constraints set by the Government. The constraints will include a cap on total plan costs to protect contributors and taxpayers, and funding requirements to ensure that benefits are properly funded. Another constraint is that the funding of each plan will be split 50-50 between employees and employers.
- Expert boards of trustees, appointed jointly by the sponsors, will ensure that the plans are administered and assets invested in the best interest of plan beneficiaries. The boards of trustees will deal directly with the service providers, Alberta Pensions Services Corporation (APS) and Alberta Investment Management Corporation (AIMCo). Once a jointly sponsored plan is in place, and following a transitional period, the plan's board of trustees will be allowed to choose providers other than AIMCo for investment management and other than APS for administration, subject to their fiduciary responsibilities to plan beneficiaries. It is currently contemplated that this transitional period will be at least five years.

Expert boards of trustees, appointed jointly by the sponsors, will ensure that the plans are administered and assets invested in the best interest of plan beneficiaries.

No changes will result in employees being better off by retiring or terminating at an earlier date than they planned.

Benefit changes will be for future service.

There will be no early retirement subsidies on pension benefits earned for service after 2015.

COLA on service after 2015 will be "targeted" at 50% of the Alberta inflation rate.

- The new jointly sponsored pension plans will have to be compliant with the Employment Pension Plans Act, which sets minimum standards for funding, benefits, investments and member information.
- There will be a moratorium on benefit improvements until January 1, 2021.
- As the SFPP, which covers municipal police, has little funding by the Government, we are asking that the stakeholders recommend plan design changes which will be implemented while the plan is in statute. Stakeholders are encouraged to take over the plan with a new governance structure and determine its direction.
- Benefit changes will be for future service. We are not proposing to change benefits earned for service before 2016. No changes will result in employees being better off by retiring or terminating at an earlier date than they planned.
- The key benefit change in the Local Authorities, Management Employees, and Public Service Pension Plans will be ending subsidies on pension benefits earned for service after 2015 for those who retire before age 65.
- Another key change for those three plans is that cost-of-living adjustments (COLA) on benefits earned after 2015 will be "targeted" at 50 per cent of the Alberta inflation rate. Contributions will be set so that there is a high likelihood that the "target" COLA will be paid, but it will no longer be guaranteed. COLAs could be reduced or suspended if the pension plan's financial status deteriorates, and "catch-up" COLAs could be made later if the plan's finances improve.
- Those already receiving pensions by the end of 2015 will continue to receive their pensions including cost-of-living adjustments (COLA) covering 60 per cent of Alberta inflation.
- Effective January 1, 2016, benefits will be vested from the first day of plan membership for active members.

These changes reduce the cost of benefits on a go-forward basis and reduce risk. They will reduce the size of any future shortfalls, which will positively affect the cost to employees and employers. They modernize benefits for tomorrow's workforce by removing incentives to retire early and by removing disincentives to work longer. These changes, we believe, will ensure that the plans are sustainable into the future and serve employees, employers and taxpayers effectively.

Public Service Pension Plan and Local Authorities Pension Plan

Plan Design Changes

Benefits for service before 2016

Service earned with an employer under the plan before 2016, or already credited to the member as a result of a purchase of prior service or a reciprocal transfer from another pension plan, will not be affected by the proposed design changes. This will apply to prior service purchases and reciprocal transfers initiated but not completed by the end of 2015.

Early retirement

This change will reduce costs by at least 3 per cent of salaries.

All early retirement subsidies will be removed for benefits earned on service after 2015. It is expected that this change will reduce costs, and thus the contribution rates for new benefits, by at least 3 per cent of salaries.

Members whose age plus service equals 85 or more have so far been allowed to retire without a reduction to their pension anytime from age 55. For service after 2015, the pension will be actuarially reduced for those who retire before age 65, to reflect the true cost of paying the pension longer.

Members will still be able to begin receiving a pension as early as age 55. For those who retire shortly after January 1, 2016, the effect will be very minimal. As the years go by, the proportion of a retiree's pension that has been earned since 2015 will increase, and thus, the financial impact of early retirement will become more significant. This will also result in lower payouts (commuted value transfers) on termination of employment for that service.

Cost-of-living adjustments

Once the finances improve, catch-up COLAs may be granted, according to the plan's funding policy.

Guaranteed COLA, currently at 60 per cent of Alberta inflation, will be changed for service after 2015 to "target COLA" at 50 per cent of Alberta inflation. COLA on service earned before 2016 will continue at 60 per cent of Alberta inflation.

The funding rules will require that the pension boards set contribution rates high enough so that the target COLA will most likely be paid, but an annual increase will be provided only if the plan's finances permit. If plan finances deteriorate, annual increases will be reduced or suspended. Once the finances improve, catch-up COLAs may be granted, according to the plan's funding policy.

35-year service maximum

The limit of 35 years for pension accrual will be removed effective January 1, 2016. Those who have more than 35 years of service at that time may resume contributing and earning benefits if they wish. Those who reach 35 years of service in the future will automatically continue to participate and earn more benefits.

Vesting

For consistency with the new standards for private sector pensions, all benefits for active members, starting in 2016, regardless of when they were earned, will be immediately vested. From their first day of plan membership, they will be entitled to the value of the benefit they have earned.

Management Employees Pension Plan

Plan Design Changes

MEPP will be closed to new members effective at the end of 2015. After 2015, new managers will participate in the PSPP.

Closure to new members

MEPP will be closed to new members effective at the end of 2015 but will continue to operate as a closed plan. Those currently in MEPP will stay in it, and receive their eventual pensions from it. The Government is not proposing to change benefits earned or credited to the end of 2015.

After 2015, new managers, including those newly promoted into management, will participate in the PSPP. Benefits in the updated PSPP are described above. No other Canadian governments provide separate pension plans with enhanced benefits for their managers.

The Government will continue to sponsor this pension plan, and the President of Treasury Board and Minister of Finance will continue to be its trustee.

For service after 2015, MEPP will provide benefits identical to the updated PSPP, except that benefits will continue to be earned at the rate of 2 per cent of salary per year of service.

Unit of benefit

For service after 2015, MEPP will provide benefits identical to the updated PSPP, except that benefits will continue to be earned at the rate of 2 per cent of salary per year of service on all pensionable earnings, as at present, rather than PSPP's lower benefit rate on earnings covered by the Canada Pension Plan.

Early retirement

All subsidies on early retirement before age 65 will be removed for benefits earned on service after 2015. It is expected that this change will reduce total plan cost by at least 5 per cent of salaries. Members whose age plus service equals 80 or more, or who are at least 60 years old, have so far been allowed to retire without a reduction to their pension anytime from age 55. For service after 2015, the pension will be reduced for those who retire before age 65, to reflect the true cost of paying the pension longer.

Normal form of pension

In respect of service after 2015, the normal form of pension will be a pension for the life of the member, guaranteed for five years after pension commencement. Retirees with spouses will receive an actuarially adjusted pension that includes a survivor pension for the spouse. This is the same as under PSPP.

For service before 2016, the current normal form of pension will remain in place. Retirees with a spouse will receive a pension which includes a survivor pension, without adjustment to the member's pension. Those without a spouse will be paid a pension for life guaranteed for 10 years after pension commencement.

In respect of service after 2015, the normal form of pension will be a pension for the life of the member, guaranteed for five years.

Cost-of-living adjustments

As under PSPP and LAPP, target COLA at 50 per cent of Alberta inflation will be provided after 2015. Guaranteed COLA at 60 per cent of inflation will continue on benefits earned to the end of 2015.

Vesting

For active members, benefits for all service after 1991 will be vested as of January 1, 2016.

Contribution rates

Starting in 2016, Government will set the employee contribution rate to MEPP by reference to the employee rate under PSPP. While it is recognized that those grandfathered in MEPP will be advantaged in terms of their benefits compared with new managers, it will be important to maintain comparability in employee contribution rates to the extent that benefits in the two plans are comparable. PSPP provides a two-step benefit accrual, namely 1.4 per cent of salary per year on earnings to the Canada Pension Plan (CPP) maximum and 2 per cent for earnings above that. The unit of benefit on all pensionable salary in MEPP is 2 per cent, and therefore, the reference point for setting MEPP contributions is the PSPP contribution rate that applies on earnings above the CPP maximum.

Employers will be responsible for the remaining cost of MEPP. As the plan is closed and the membership will age with no new members joining the plan, the employer costs are expected to increase.

For the managers who earn salaries exceeding the limits for Registered Pension Plans set out by the federal Income Tax Act, it is anticipated that the Supplementary Retirement Plan for Public Service Managers (SRP) will continue for managers in both MEPP and PSPP, but will provide more modest benefits for service after 2015.

The Supplementary Retirement Plan for Public Service Managers (SRP) will provide more modest benefits for service after 2015.

Special Forces Pension Plan

Employee and employer stakeholders will directly determine the future of this plan.

It is recognized that there is little provincial taxpayer funding of this plan, except for the pre-1992 obligation. Therefore, the Government would like the SFPP to move out of statute and become a plan established by sponsor and trust agreements, subject to the Employment Pension Plans Act. Employee and employer stakeholders will directly determine the future of this plan. The Province's obligation toward the pre-1992 benefits will remain unchanged.

SFPP stakeholders are urged to reflect on the changes that are being proposed for the other plans, and to consider reducing the early retirement incentives under SFPP. The provision which allows an unreduced pension after 25 years of service may no longer be appropriate.

SFPP stakeholders are being asked to provide recommendations for benefits changes to improve plan sustainability. The changes will be implemented by Government before the plan becomes jointly sponsored.

Governance Changes for LAPP, PSPP and SFPP

The following governance changes will not apply to the MEPP, which will continue to be sponsored and trusteed by the Government. It is anticipated that the MEPP Board will be discontinued at the end of 2015. An advisory committee will be established to provide advice to the Minister. Its role will include providing advice on the SRP and the pre-1992 Public Service Management (Closed Membership) Pension Plan.

Because those who bear the risks need to be able to manage the risks, we intend to give employee and employer sponsors the mandate to establish new plans outside of statute, governed independently.

Because those who bear the risks need to be able to manage the risks through the governance system, we intend to give employee and employer sponsors of each of the plans the mandate to come to an agreement to establish a new plan outside of statute, governed independently.

Such plans will have a bicameral governance structure, separating the handling of sponsor activities and decisions from fiduciary activities and decisions. Therefore two governance bodies will be created for each plan.

A sponsor body will represent members of the plan and their employers. The Government will set out the sponsoring organizations, e.g., employers and unions, in the enabling legislation and how many seats each will have, and those organizations will appoint representatives to occupy those seats as they see fit. The sponsor group for each plan will be mandated to establish a sponsorship agreement, (including the mandate of the sponsor body), a plan document and a joint trust agreement for administering the plan.

The sponsor body will have ongoing responsibilities in the new governance structure – not just in the initial establishment of the new plan and governance structure. It will set the funding and benefits policies, and make changes to the pension deal when needed to keep the plan affordable and sustainable.

The sponsor body will also collectively appoint a board of trustees made up of experts in relevant fields such as finance and risk management who will have a purely fiduciary role. The trust agreement would set out the powers of the Board of Trustees, for example, employing staff, setting contribution rates, setting investment policy, contracting with and monitoring service providers, and ensuring that the plan is compliant with the sponsors' funding and benefits policies, the Employment Pension Plans Act and the Income Tax Act. The trustees will support the sponsor body by providing the information they need for their decision-making.

Once a jointly sponsored plan is in place, and following a transitional period, the plan's board of trustees will be allowed to choose providers other than AIMCo for investment management and other than Alberta Pensions Services Corporation for administration, subject to their fiduciary responsibilities to plan beneficiaries. It is currently contemplated that this transitional period will be at least five years.

The managed framework includes a legislated cap on contribution rates.

The managed framework includes a legislated maximum or "cap" on contribution rates. The funding and benefits policy established by the sponsors must set out the sharing of costs between employees and employers, how benefits will be reduced when this cap is reached, and how benefit improvements or contribution adjustments will be made when the plan's funding improves.

The cap for each plan will be set following further consultation and analysis. Two possible ways of setting the maximum are either a total percentage of payroll, or a multiple of current service costs (to take into account the need to fund any shortfalls as well as current service). Transitional provisions will be put in place so that the current unfunded liabilities can continue to be paid under their current schedules. The Government will be able to modify the caps in the future, perhaps for unforeseen reasons.

Spring 2014 Legislation

In proposing this vision, the President of Treasury Board and Minister of Finance is exercising his authority and responsibility for the fiscal management of the province, as trustee of the plans and as Minister responsible for the public sector pension system. It is the goal of the Government to set these plans on the right course, with sustainable benefits and a governance system that puts responsibility in the right hands and enables the plans to adapt to whatever the future may hold.

To allow these reforms to get underway, the Public Sector Pension Plans Act, which established and continued the current plans and their governance structure, will have to be amended.

Enabling legislation will be tabled in the Legislative Assembly in Spring 2014.

The legislation will give Government the ability to put plan design changes in place without a recommendation from the board.

It will close MEPP to new entrants effective at the end of 2015. For PSPP, LAPP, and SFPP, the legislation will give Government the ability to put plan design changes in place by regulation without a recommendation from the board. This will enable the plan design changes to be effective January 1, 2016. The legislation will name the employee and employer sponsors of each plan and empower them to come to an agreement to make their respective plan jointly sponsored.

The legislation will name the employee and employer sponsors of each plan.

The legislation will place certain constraints on the sponsors.

For example:

- The plans will be subject to the Employment Pension Plans Act rules for jointly sponsored plans.
- For a transitional period of at least five years, trustees of the jointly sponsored plans will not be allowed to choose a provider other than AIMCo for investment management and APS for administration. Thereafter, they will be allowed to exercise that option, subject to their fiduciary responsibilities to plan beneficiaries.

The funding of the new plans will be split 50-50 between employees and employers.

- Until January 1, 2021, benefit improvements will not be permitted.
- The trustee boards will be fiduciary rather than representative, and will consist of experts.
- The funding of the plan will be split 50-50 between employees and employers.
- There will be a contribution rate cap for each plan that can be changed from time to time.
- The current governance arrangements for PSPP, LAPP and SFPP will continue until a new pension plan and governance arrangement is in place.

Next Steps

The current pension boards and the major employee and employer stakeholders will have important roles until the time new governance arrangements are put in place.

From now until the end of 2013, stakeholders are urged to provide their comments and recommendations.

Current pension boards

Plan boards have important duties to keep the current pension plans running. The PSPP, LAPP and SFPP boards will continue in their current roles until the sponsors reach a sponsorship agreement and new governance arrangements are implemented.

The Government of Alberta is asking boards, their staff, and plan actuaries to provide advice and information to the department on any issues moving forward. An example is advice about the makeup of the sponsor body for their plan.

It is hoped that the boards' staff will work closely with Government so that plan members and employers are well informed on what is being proposed and why. They will also act as points of contact for members and employers to ask questions or to express their views.

Stakeholders/Sponsors

From now until the end of 2013, stakeholders are urged to provide their comments and recommendations on any and all of the aspects of this Vision document, including recommendations about which entities should be sponsors of the new plans.

After the Spring 2014 legislation is in place, the named sponsors will have the power and responsibility to work together to set up a sponsor agreement that meets the requirements of legislation. The Government would consider providing assistance to launch and advance this process, if necessary.

The PSPP, LAPP and SFPP boards will continue in their current roles until new governance arrangements are implemented.

Conclusion

This vision for plan design and governance meets the principles set out earlier.

- The managed defined benefit pension plans will continue to provide adequate, competitive, affordable, cost-effective pensions with a high degree of benefit security.
- The lower contribution rates will be attractive to new, young public servants.
- Benefits already earned are preserved, and members and employers are being given adequate notice of the changes.

- Early retirement subsidies will no longer result in inequities between members and decisions by workers that do not make sense from a human resource planning perspective.
- The proposed changes do not shift a large financial burden to future taxpayers and members.
- Employees and public employers, who bear the cost and risk, will be able to manage that cost and risk by governing their own pension plans.
- The pension plans will be adaptable in changing circumstances – in good times or bad.
- The contributions cap ensures that the plan governors are accountable to taxpayers as well as to plan beneficiaries for the overall cost of the system.

Further information is available at **http://pensionsustainability.alberta.ca**

Comments can be e-mailed to: **pensionreform@gov.ab.ca**.